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C O N F I D E N T I A L SECTION 01 OF 02 TAIPEI 003289

SIPDIS

DEPT PASS TO AIT/W AND USTR
DEPT FOR EAP/TC, EAP/EP AND EB/IFD/OIA
TREASURY FOR OASIA ZELIKOW, WISNER AND OCC AMCMAHON
TREASURY ALSO PASS TO FEDERAL RESERVE BOARD OF GOVERNORS,
SAN FRANCISO FRB AND NEW YORK FRB

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TAGS: ECON EFIN PINR PREL TW
SUBJECT: TAIWAN ECONOMIC BRIEF JULY 2005

Classified By: AIT DIRECTOR DOUGLAS PAAL, REASON 1.5 B/D

¶1. (U) This cable summarizes selected recent economic events in Taiwan in May 2005:

-- Economic Growth

-- Tax Reform

-- China's Lenovo Breaks Taiwan Barrier

-- High-speed Rail

-- Boeing Delivers New Aircraft to EVA

Think Tanks Lower Economic Growth Estimated for 2005

¶12. (U) The Taiwan Institute of Economic Research (TIER) reduced Taiwan's estimated growth rate to 3.3% from the 4.4% estimated in April. TIER attributed the downward adjustment mainly to lower than expected export growth in the first half of 2005. The Chunghua Institution for Economic Research (CIER) cut its estimate of the growth rate to 3.8% from 4.1% predicted in April. CIER blamed inventory reduction and industry emigration. Industrial relocation contributed to a new low for the past two years in Q2 y-o-y export growth, declines in manufacturing production in Q1 and Q2, and low private investment growth. Higher produce prices and higher energy costs are building inflationary pressure, but these are partly offset by stable prices for other goods and services. School graduates joining the labor market drove up the unemployment rate slightly.

Alternate Minimum Tax

¶13. (U) In late July 2005, the Ministry of Finance (MOF) ended a three-month interagency conference on the proposed alternate minimum tax system, an important part of Taiwan's tax reform. Despite industry calls to reduce the rate from 10% to 7.5%, the proposed minimum tax for businesses is 10%. For individuals earning at least NT\$10 million before taxes, the proposed minimum tax is 20%. The alternate minimum tax proposal has cause grave concern to U.S. investors that Taiwan may renege its earlier commitment of tax incentives.

¶14. (C) Hong Chi-chang, a senior DPP legislator, told AIT that President Chen told a small group of senior legislators and officials that he would not cave to business pressure on this. He said he would be willing to consider reducing the alternative tax rate in LY caucus negotiations with the KMT if necessary to pass the legislation.

Lenovo Investment Will Break Barrier on PRC Investment

¶15. (U) On July 19, Mainland Affairs Council (MAC) Chairman Joseph Wu announced that MAC had approved PRC PC manufacturer Lenovo's plan to acquire with Taiwan's IBM PC division via its Dutch subsidiary. Taiwan's Executive Yuan will also have to approve the plan. This is the first case of Taiwan government approval of Mainland investment in Taiwan. MAC Economic Department Director Fu Don-cheng told AIT/T that the Lenovo case would not become a model for Mainland firms to invest in Taiwan. According to Fu, all such investment proposals will be assessed on a case-by-case basis. However, the fact that Taiwan is willing to consider such applications at all marks a shift in Taiwan's posture toward PRC investment, made easier by the cover provided by the IBM acquisition.

Further Delays for High-Speed Rail?

¶16. (U) On July 23, Japanese media reported that it is likely that the inauguration of Taiwan's high-speed rail would be postponed beyond the October 2005 target due to construction delays for the electronic core systems. As of July 23, these systems were only 60 percent complete. The Taiwan High-Speed

Rail Corporation (THSRC) denied all rumors of delay and reconfirmed that the system would begin operations in October as planned. Furthermore, on July 22, THSRC Assistant Vice President Ted Chia told the Taipei Times that the company expected to raise NT\$ 5.5 billion (USD 171 million) of capital by July 31 and an additional NT\$ 2 billion (USD 63 million) by the end of September. THSRC has repeatedly had trouble meeting its financing targets and has had to revise its financing plan at least 11 times.

Boeing Delivers to EVA Air

¶7. (U) On July 29, Taiwan's EVA Airways celebrated the delivery of the airline's first of 15 Boeing 777-300ER (Extended Range) aircraft. EVA Chairman Steve Lin and President K.W. Chang presided over a ceremony attended by Boeing Vice President for Sales Larry Dickenson and AIT/T Economic and Commercial sections. Chairman Lin told AIT the new plane offers significant savings in fuel costs over any other type of plane available.

PAAL